What Does Recapture Mean for You?

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If you are buying your first home, a Mortgage Credit Certificate (MCC) from the N.C. Housing Finance Agency can put more money in your pocket by saving you up to $2,000 a year in federal taxes. However, since the benefits of the MCC program target buyers with low and moderate incomes, it includes a federal recapture tax provision for those borrowers who meet three criteria - sell within nine years, realize a profit ***and*** have a significant gain in household income. All three things must happen for a recapture tax to be a possibility.

For most people, the financial benefits of home ownership – deductions that can be taken for mortgage interest and taxes – far outweigh the small risk and potential amount of recapture tax. However, unnecessary fear about recapture among home buyers, real estate agents, home builders, and even some mortgage professionals can cause eligible borrowers to miss out on this valuable benefit.

Removing the Mystery

Recapture tax is a federal IRS provision that requires homeowners who use an MCC to potentially repay the federal government a portion of the gain from sale of their home under specific, limited circumstances. For many people though, recapture tax is not owed. For the tax to apply, the homeowner must have all three of the following occur:

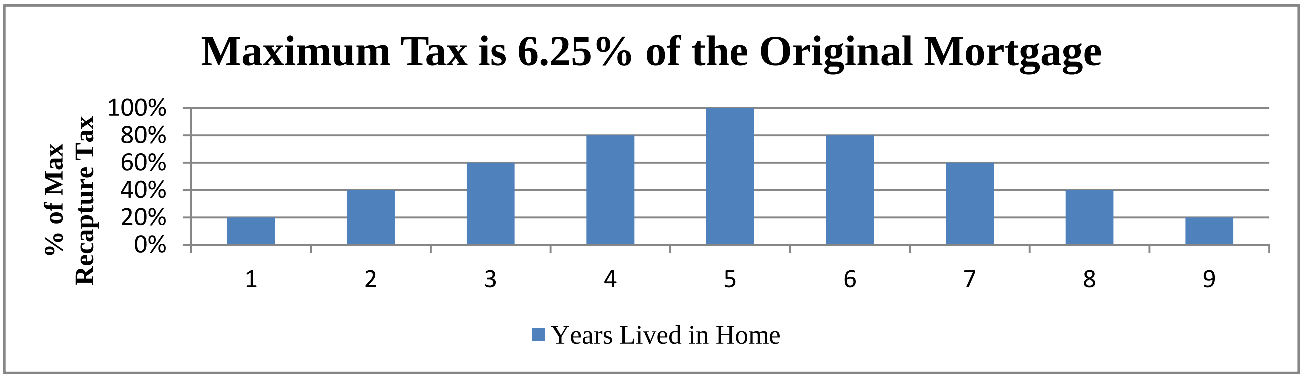
- Sell their home within nine years of purchase
- Have a significant increase in household income – more than 5% yearly above the income limits in effect when the home was bought for each year the home is owned
- Realize a gain (profit) from the sale of their home.

If recapture is due, it is paid as part of the homeowner's federal income tax liability for the year the home is sold.

Calculating Recapture

For the limited number of homeowners who have to pay recapture, the tax guidelines are structured to help reduce the impact. The maximum amount of recapture is 6.25% of the original loan amount or 50% of the gain from the sale, whichever is less. Gain from the home's sale is calculated after deducting future real estate agent's commission, legal fees and closing costs.

Here's an example. Say Fred's household income was $40,000 when he purchased his home, but the income limit to qualify for an MCC was $56,000. Before recapture is considered, Fred's household income must increase above the $56,000 maximum qualifying income by 5% each year he owns the home. If he sells in Year 5, recapture is not considered unless his household income is more than 25% higher, meaning above $71,472.



Further limiting the potential impact is that the maximum rate of 6.25% of the original mortgage amount is then reduced further based on how long the owners occupy the home, as shown in the chart above.

If Fred is to pay 6.25% of the loan amount and he sells his home in any year other than Year 5, the amount owed would be further reduced. For example, if he sells in Years 2 or 8, he would only pay 40% of the 6.25% or 2.5% times the original loan amount.

As you can see from the scenario above, even when recapture tax is owed, the net effect is minimized by application of these three factors.

Frequently Asked Questions

Can the N.C Housing Finance Agency or the lender tell me what my recapture tax will be?

No. Because it would be impossible to predict what your future income, date of sale or profit may be. In addition, neither the Agency nor the lender is qualified to interpret tax regulations. The lender and the Agency only provide information alerting you to the potential for recapture when you purchase your home. You will receive a *Notice of Recapture* form from your lender when you apply for an MCC. Within 90 days after closing, you will also receive a personalized *Recapture Statement Disclosure* from the Agency.

How does the IRS track the amount of recapture tax due?

The borrower is required to file IRS Form 8828 with their federal income tax return for the year the home is sold or transferred.

When do I pay the recapture tax?

Any recapture tax due is to be submitted with your individual tax return for the year in which you sold or transferred the property. For example, if you sold your home in 2014, any recapture tax, along with IRS Form 8828, must be submitted with your IRS 1040 federal tax return in 2015.

Does refinancing my mortgage activate the Recapture Tax?

No. However, it does not eliminate the potential recapture tax either. If you refinance your loan and then sell your house within the first nine years of ownership, the potential for recapture still exists.

More Information

To learn more about the MCC program, call (800) 393-0988 or go to www.nchfa.com. You may also want to consult with a tax professional to determine if an MCC is right for you.

North Carolina Housing Finance Agency

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